



Q4 2026 OUTLOOK: THE REVISION OF BELIEF



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Imagine Taleb's Turkey. From its hatching, it had been cared for by ostensibly benevolent humans. They fed him—always plenty of corn to eat, they kept him warm in the winter, they protected him from cats and hawks when he was young, and foxes when he was larger. It was a good life. Every yesterday validated his belief that today will be the same, and that tomorrow would too. Then, suddenly, two weeks before Thanksgiving, the turkey experienced a sudden revision of belief.

What about more gradual revisions of belief? A slow realization that previous assumptions about the world are no longer true. Finance professionals are living through that uncertainty now. Previous assumptions about AI, interest and inflation rates, and demographics are changing. These forces of uncertainty are shaping financial markets and the world even for those who don't know they are occurring.

Tom Turkey Updates His Priors

Imagine now Tom Turkey, an average 35-year-old white collar worker. He is currently experiencing a lot of firsts. He has never, as an adult, seen mortgage rates above 7.0%. With his current 4.0% mortgage he's not going to move anytime soon. He has never experienced a true bear market—he was only 17 when the 2008 crisis occurred. AI is new for him too. He wonders what job he should tell his children to study for—isn't AI going to disrupt every job? He sees how much his AC bill costs in the summer and knows the demand for power is now increasing—the first time that has happened in his lifetime. With so much of the world changing, what should investors do?

Uncertainty is THE investing theme of 2026. Think of AI, interest rates and inflation, energy, and demographics. Each element has been stable for a generation, and each has now strayed into new territory. Previous assumptions about the world have not held, and there is little expert consensus on what replaces them. These narratives will shape the remainder of the year and 2027.

We discuss the market impact of these factors after a review of Q3 market activity.

US and Global Market Summary

- **Global Real GDP Growth Broadly Unchanged:** The IMF projects growth of 3.1% in 2026 and 3.4% in 2027, a 0.1-pt upgrade from April, as AI-driven demand offsets the Middle East war's drag on energy importers.
- **U.S.-Iran Conflict Causing Elevated Brent Prices:** Brent crude is sitting above \$109 a barrel as of early October, up over 80% from a year ago. Export constraints expected to persist through year-end, with Brent averaging \$105 in the second half of 2026 before easing in 2027.
- **Consumer Confidence Near All-Time Low:** The University of Michigan Consumer Sentiment Index fell to the second-lowest level in its 74-year history. Americans expect gas prices to keep climbing, and expect inflation of 4.7% over the next year.
- **AI Rally Powers Through Rate Spike:** The Nasdaq broke the 27,000 threshold in September and the S&P 500 finished at near highs before a jump in bond yields sparked a pullback in the final week. Both still finished the quarter higher, while the Dow slipped.

Economic Performance

- **Global Growth Set to Cool After a Strong Finish to 2026:** The Atlanta Fed's GDPNow model estimates the economy grew at a 3.5% annualized rate in Q3, well above Q2's 2.2%. The first official Q3 reading is due October 29, and the Fed expects growth to settle near 2.4% next year.
- **Hiring Hits the Brakes:** Employers added just 29,000 jobs in September, about a third of what economists expected, while unemployment rose to 4.2%. Healthcare did most of the hiring, while more than 25% of job seekers have been looking for over six months.
- **Inflation Stays Sticky:** Consumer prices rose 3.7% over the past year, with gasoline driving over half of the monthly increase. Core PCE (which strips out food and energy) came in cooler than expected at 3.0% but remains well above the Fed's 2% target.
- **Mortgage Rates Break 7%:** The average 30-year mortgage rate rose to 7.40% by the beginning of October. Freddie Mac's weekly survey crossed 7% on September 24 for the first time since January 2025. Home sales slipped again in August, while the supply of homes for sale hit its highest level in over a decade, giving buyers more bargaining power.

Monetary Policy

- **Fed Hikes for the First Time Since 2023:** The Fed raised rates to 3.75%–4.00% on September 16. Officials' projections point to one more hike this year and no cuts in 2027. Markets now see roughly a 16% chance of another hike at the October 28 meeting.
- **Warsh Rewrites the Playbook:** Chair Warsh stated, "I'm not in the forward guidance business," after the September meeting. "Trends matter. Data points are noisy." Expect fewer hints about the Fed's next move, and bigger market reactions to each meeting.
- **The World Tightens Together:** Central banks are raising rates to fight energy-driven inflation. The ECB, Bank of Japan and Norway's central bank all hiked in September, while the Bank of England held.

Central Bank	September Move	Policy Rate
Federal Reserve	Hike	3.75%–4.00%
European Central Bank	Hike	2.50%
Bank of Japan	Hike	1.25%
Norges Bank (Norway)	Hike	4.50%
Bank of England	Hold	3.75%

Credit Market Performance

- **Rate Spike Hits Bonds; Loans Hold Up:** A late-September selloff pushed both high-yield and investment-grade bonds into the red for Q3, with longer-duration investment grade hit hardest. Floating-rate loans held up better. Spreads widened in the final week but remain tight by historical standards.

Sector	Q3 Return	Spread vs. Treasuries (9/30)
High Yield	-2.43%	3.12%
Investment Grade	-3.8%	0.84%
Leveraged Loans	0.21%	—

- **Private Credit Pricing Power Grows:** Direct lenders are getting paid more to lend. New private loans now pay about 1.6% more than comparable syndicated loans, up from roughly 1.2% in Q1, while credit quality in core sectors like software remains solid.
- **Stress Concentrated in Small Borrowers:** Direct lending stress is mostly a small-company problem. Among borrowers with less than \$20 million in annual earnings, 12% of loans are now valued below 90 cents on the dollar, up from 1% in 2023. Overall direct lending defaults remain under 1% of loan value, with healthcare the most stressed sector.
- **Software Overcomes AI Disruption Fears (For Now):** After a rough first half, software loans were the top-performing sector in August and led the loan market again in September. The bigger test comes in 2027–2028, when a large wave of software debt comes due.
- **AI Data Center Debt Financing Accelerates:** Big Tech is borrowing more to fund AI. Hyperscalers are on pace to issue about \$250 billion in investment-grade bonds this year, more than double 2025, and Goldman Sachs expects that to climb to roughly \$420 billion in 2027 as debt funds over a third of AI spending.

Markets*

	As of 9.30.2026	Q3 Return	2026 YTD
S&P 500	7,651.54 pts	2.0%	11.8%
NASDAQ	26,861.06 pts	2.5%	15.6%
The Dow	50,906.05 pts	-2.7%	5.9%
Global Equities		5.4%	13.7%
Emerging Markets		-2.4%	22.1%
Energy		15.8%	37.6%
Gas	\$5.30/gal	19.2%	58.0%
Gold	\$4,157.38/oz	3.7%	-3.8%
VIX	16.34 pts	-0.7%	9.3%
10-Yr Treasury	5.285%	82.0 bps	111.8 bps

*See end notes for sourcing information.

Alternatives*

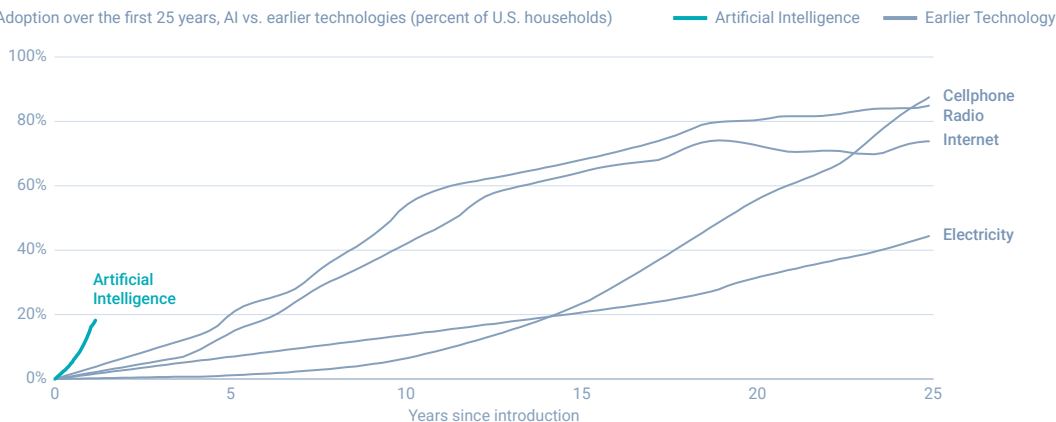
	Q3 Return	2026 YTD
Direct Lending	1.8%	-6.2%
CLOs	2.0%	4.4%
Private Equity	1.1%	-16.1%
Hedge Funds	1.7%	6.6%
Equity REITs	-5.4%	4.2%
Residential REITs	-10.2%	-5.8%
Industrial REITs	-1.4%	4.9%
Wine & Cheese	-10.9%	-10.3%
Crypto Market	54.2%	-8.8%
SPACs	-15.6%	1.5%

AI – We Are Just Getting Started

Is it just a toy or a tidal wave sweeping over and swamping every other aspect of work, art, and society? AI is now so embedded in the world that it's easy to forget that ChatGPT was first released in November 2022. AI has been adopted faster than any technology in history.

AI Is the Fastest-Adopted Technology in History

Adoption over the first 25 years, AI vs. earlier technologies (percent of U.S. households)



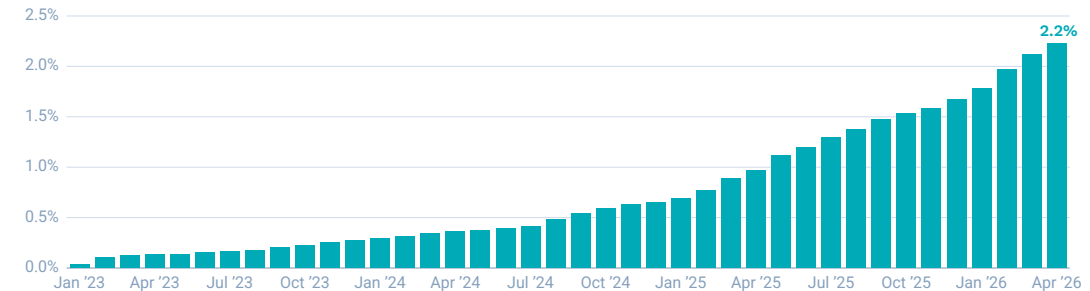
Source: Microsoft AI Economy Institute, AI Diffusion Report, November 2025. Historical adoption data: W. Michael Cox and Richard Alm, "You Are What You Spend," The New York Times, February 2008; Internet data: Our World in Data.

AI continues to advance. Navier–Stokes is solved¹. But the demand for AI is nowhere near satisfied. Less than 25% of workers use AI daily. And for personal use, penetration is low. Fewer than 3% of households have a paid AI subscription.

¹ For nearly two centuries, the Navier-Stokes equations have been relied on by engineers but not proven by mathematicians. The million-dollar question (literally: it's one of the seven Clay Mathematics Institute's \$1 million prize problems) was whether the equations always remain smooth, or whether they can sometimes blow up into mathematical nonsense. The problem remained intractable until September 2026 when OpenAI announced that its AI agents had solved it. There was applause and then revulsion from the math community. As journalist Derek Thompson describes the mathematicians: "...some are crying about bruised egos, the feeling of wasted years, a creeping sense of status obliteration, the frustration of an unfair competitor, the indignation of feeling cheated and mistreated, and uncertainty about the future."

More Households Are Paying for AI

Share of US households with paid AI subscriptions, January 2023–April 2026



Source: PNC Economics Research, Consumer Health Check, June 15, 2026, based on PNC internal card data; as charted in Andreessen Horowitz (a16z), State of Markets II, September 30, 2026.

In other words, there is a lot more demand possible. In the meantime, AI's expansion will require a lot more infrastructure investment, grid expansion, and capital.

Interest Rates and Inflation – Higher for Longer

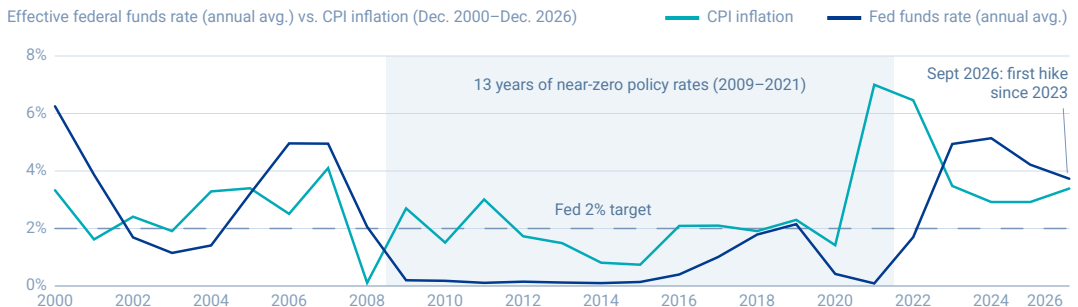
Both interest rates and inflation were low starting from the financial crisis through COVID. Low rates drove the financialization of the economy, private equity primacy, wage stagnation, asset inflation. This was the turkey being fed and protected. Now, it's Thanksgiving. For many people, post-COVID is the first time they have seen 7% mortgage rates and inflation above 2%.

The effective fed funds rate averaged well under 1% from 2009 through 2021, the 10-year Treasury spent most of that stretch below 3%, and a 30-year mortgage could be had for three-and-change. Homebuyers, corporate treasurers, and lenders built their models, their habits, and their intuitions on that regime.

The 2022 shock looked, for a while, like a storm that would pass. By late 2025 the Fed had cut three times to 3.50%–3.75%, and the old script—inflation fades, rates drift back down—seemed to be reasserting itself. It was not to be. On September 16, 2026, the FOMC, under Chair Kevin Warsh, voted unanimously to raise the target range to 3.75%–4.00%, the first increase since 2023, citing solid growth, elevated inflation, and, pointedly, geopolitical developments.

A Generation of Cheap Money, Then a Revision

Effective federal funds rate (annual avg.) vs. CPI inflation (Dec. 2000–Dec. 2026)



Source: Board of Governors of the Federal Reserve System, Effective Federal Funds Rate (FEDFUNDS), via FRED, Federal Reserve Bank of St. Louis; U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers (CPI-U), all items, 12-month percent change, not seasonally adjusted. 2026 figures: fed funds year-to-date average CPI for the 12 months ending September 2026. The Fed formally adopted its 2% inflation target in January 2012. Data as of October 2026.

Long rates continue to rise. The 10-year Treasury ended the quarter at 5.29%, its highest since 2007 after the largest quarterly rise this century; the 30-year touched levels last seen in 2004; and the 30-year mortgage is back above 7%.

Home sales have fallen off steeply

U.S. home sales, relative to household population (total sales, new and existing, %)

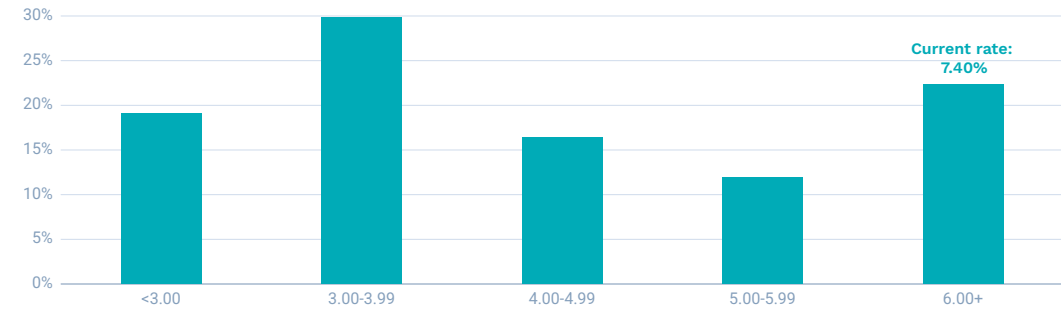


Sources: Census Bureau, National Association of Realtors, Haver Analytics. Data as of March 31, 2026.

For borrowers who came of age believing 7% mortgages and 3% inflation were mere historical curiosities, the gradual awakening continues. The housing market is locking up due to higher rates and borrowers reluctant to borrow at higher rates. For investors, bonds are beginning to look attractive again as the term premium is being rebuilt after a fifteen-year holiday. Floating rate lenders have a natural hedge while fixed rate lenders have seen steep price declines.

Many Homeowners Are Still Reluctant to Give Up Very Low Mortgage Rates

Distribution of Rates on Outstanding Mortgages



Note: Current rate is the 30-year fixed rate as of 10/8/2026 (7.40%). Buckets are 1-point; adjustable-rate mortgages (4.3%) excluded.
Source: FHFA National Mortgage Database, Q2 2026 (distribution of rates on outstanding mortgages); Freddie Mac PMMS.

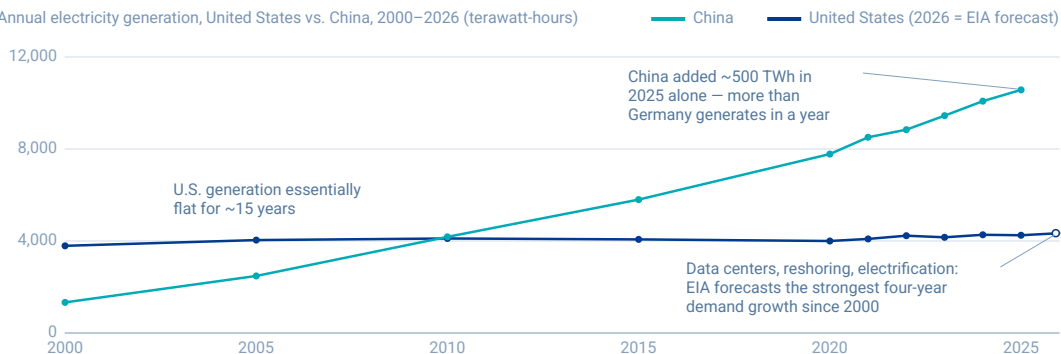
Energy – We Need More

From roughly 2007 to 2020, U.S. electricity generation did not grow. Efficiency gains kept overall consumption flat as population grew. A utility planner could assume flat load forever, so capacity was not built.

China, meanwhile, went from roughly 1,400 terawatt-hours in 2000 to about 10,600 in 2025, two and a half times U.S. output. In 2025 alone it added nearly 500 TWh of generation, about the size of Germany's entire grid, and 550 gigawatts of capacity.

Electricity Generation: The U.S. Stood Still While China Built

Annual electricity generation, United States vs. China, 2000–2026 (terawatt-hours)



Source: U.S. Energy Information Administration (EIA), Electric Power Annual and Short-Term Energy Outlook ([month] 2026; 2026 U.S. value is an EIA forecast); Ember, Yearly Electricity Data (China); German Federal Statistical Office (Destatis) for the Germany comparison. China figures may differ from National Bureau of Statistics totals, which exclude some small-scale generation. Chart adapted from Steve Rattner.

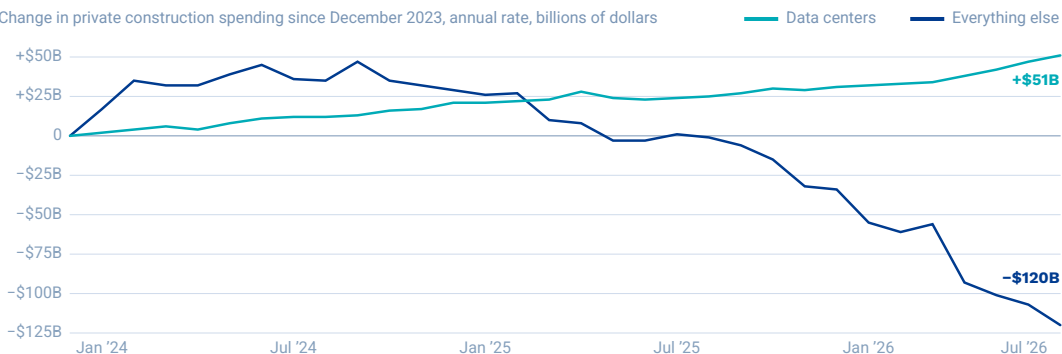
We are now playing catchup. Data centers, reshored manufacturing, and the electrification of homes and transport have pushed U.S. demand onto a new trajectory. Whether the hyperscalers' announced capacity will actually be built, and on what timeline, is one of the genuinely open questions of the year. What is not in question is that the grid was sized for the old world.

Closing that gap is an infrastructure problem and an energy problem. Investor-owned utilities plan on the order of \$1.1 trillion of capital spending over 2025–2029, most of it grid and generation, and the IEA estimates global grid investment must roughly double from about \$400 billion a year to keep pace with electrification. Add the hyperscalers' own build—data center capital spending now runs in the hundreds of billions annually and is increasingly debt-financed—and the total is on a scale that public budgets and utility balance sheets cannot carry alone.

That is why infrastructure investing is now a focus of institutional investors. Generation, transmission, pipelines, LNG terminals, and the digital backbone of data centers and fiber are long-lived assets with contracted or regulated cash flows, often inflation-linked, being built because they must be. Private capital is increasingly the source of both the equity and the credit behind them. The old belief—that infrastructure was a sleepy, low-return corner of the market—is being revised along with everything else.

Data Centers Are the Only Private Construction Still Growing

Change in private construction spending since December 2023, annual rate, billions of dollars



Source: U.S. Census Bureau, Value of Construction Put in Place (C30), seasonally adjusted annual rate; total private construction via FRED. "All other" is total private construction less data centers. Figures are the change in the annualized rate of spending from its December 2023 level, not cumulative dollars spent. Latest observation July 2026. Chart adapted from Steve Rattner.

Demographics

In 1968, Paul Ehrlich's book "The Population Bomb" was a best seller. It warned that we were entering a new Malthusian age where population growth would exceed food supplies. Mass starvation and social collapse were sure to follow. He was wrong, of course. Prophets of doom usually are.

The U.S. total fertility rate fell to about 1.6 births per woman in 2024, a record low and well under the 2.1 replacement level. South Korea's is near 0.75, Japan's about 1.15, and China's has fallen to roughly 1.0, with its population shrinking for a fourth consecutive year. For a generation the working assumption was that populations grow, labor forces expand, and consumer markets with them. That is no longer true almost anywhere in the developed world. Pension funds and social spending will be forced to adjust over the next decades.

For investors, the demographic math surfaces as slower trend growth, entitlement burdens that keep pressure on deficits and long rates, wage inflation in physical industries, and secular demand for housing, healthcare, and automation.

Now What?

The turkey's error was not optimism; it was mistaking a long run of confirmations for proof. Across each theme—AI, rates and inflation, energy, demographics—a generation-long assumption has been changed, gradually and then all at once, and the experts disagree about what replaces it. For investors the practical lesson is humility about the base case and attention to what is being rebuilt. Tom Turkey, unlike his namesake, still gets to revise his beliefs and act on them. So do we.

Endnotes

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